

GAO

Report to the Chairman, Committee on
International Relations, House of
Representatives

August 1999

FOREIGN ASSISTANCE

U.S. Economic and Democratic Assistance to the Central Asian Republics



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United States General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-283079

August 11, 1999

The Honorable Benjamin A. Gilman
Chairman, Committee on International Relations
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we examine the economic and democratic assistance that the United States has provided to the Central Asian Republics of Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. With the break up of the Soviet Union in 1991, the United States has provided a broad foreign assistance program to these republics, including development of market-oriented economies and democracy building.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies to the Honorable Madeleine K. Albright, the Secretary of State; the Honorable Harriet C. Babbitt, the Acting Administrator of the U.S. Agency for International Development; and other interested congressional committees. We will also make copies available to others upon request.

Please contact me at (202) 512-4128 if you or your staff have any questions about this report. Other GAO contacts and staff acknowledgements are listed in appendix II.

Sincerely yours,

Benjamin F. Nelson
Director, International Relations and
Trade Issues

Executive Summary

Purpose

With the breakup of the Soviet Union in 1991, the five countries that comprise the Central Asian Republics (CAR)¹—Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan—became independent along with Russia and the other former republics of the Soviet Union. The United States has important strategic interests in CAR, including dismantling Kazakhstan's nuclear arsenal; developing oil and gas reserves; and helping stabilize a region surrounded by China, Iran, and Russia.

The FREEDOM Support Act of 1992 authorized a broad foreign assistance program for the independent states of the former Soviet Union that included development of market-oriented economies and democracy building.² Since fiscal year 1993, the U.S. Agency for International Development (USAID) has provided about \$274 million for economic and democratic reform initiatives in the five republics. Expressing concern about what USAID has accomplished in CAR and USAID's oversight of its CAR programs, the Chairman, House Committee on International Relations, asked GAO to determine

- what USAID's economic and democratic reform initiatives in CAR were designed to achieve; what has been accomplished; and what factors, if any, have limited the implementation of reforms;
- whether lessons learned from similar USAID programs in Central Europe³ and Russia have been applied in CAR; and
- how USAID ensures that its assistance funds in CAR are spent for intended purposes.

Results in Brief

USAID's economic and democratic reform initiatives in the five republics are designed to help develop market-oriented economies, increase citizen participation in economic and political decision-making, and promote more democratic and responsive governments. With USAID and other donor assistance, the CAR governments have made progress in this regard. Most notably, Kazakhstan and the Kyrgyz Republic—the two republics most committed to reforms—have privatized many small and medium-sized,

¹CAR is a term of convenience applied by the Department of State to the five independent republics and does not signify a political or economic union among them.

²The "Freedom for Russian and Emerging Eurasian Democracies and Open Markets Support Act of 1992," also known as the FREEDOM Support Act. (P.L. 102-511, 106 Stat. 3320, 22 U.S.C. sec. 5801).

³The Central European countries gained their independence from the Soviet Union in 1989.

state-owned enterprises; implemented trade and financial reforms; and developed nongovernmental organizations and independent broadcast news stations to encourage greater citizen involvement in governmental activities.

However, the goal of reaching a market-oriented democracy in each of these five republics is decades away. Even those republics that appear to have the greatest commitment to reform—Kazakhstan and the Kyrgyz Republic—have not completed many reforms. For example, both still have many large, state-owned enterprises that have not been privatized and new tax codes that have not been effectively enforced. With the exception of the Kyrgyz Republic, none have supported key democratic reforms, such as holding fair and free elections. Several important factors have affected the implementation of reforms in all the republics, including long-standing government corruption; inadequate resources to implement and enforce new laws and regulations; inexperience in managing market economies and democracies; and, most importantly, the governments' limited commitment to implement comprehensive reforms at the national level.

USAID's programs in CAR reflect numerous lessons learned from similar programs in Central Europe and Russia. For instance, based on efforts to privatize economies in Central European countries, USAID designed an integrated program to privatize the CAR economies, stressing simultaneous reforms in the fiscal, legal, and financial sectors. Similarly, based on experience with democratic reforms in Russia, USAID has focused on working with citizen groups rather than with national political leaders and institutions that are adverse to reforms.

To ensure that assistance funds are spent for intended purposes, USAID requires that cognizant technical officers carry out various project oversight requirements. Based on GAO's review of 14 CAR projects, USAID was meeting these requirements.

Background

Based on the FREEDOM Support Act of 1992, the current U.S. strategy for CAR seeks to have each country adopt and implement policies, laws, and regulations that provide the framework for market-oriented economies and

democratic societies.⁴ The strategy provides the basis for USAID's economic and democratic reform initiatives.

Complicating USAID's efforts, however, is the region's long history of isolation. According to USAID, over 150 years of Russian and Soviet domination left CAR isolated from western technology, economic progress, and political development. In addition, unlike the other newly independent states (NIS) in the former Soviet Union and Central Europe, CAR had no history as independent nation states. The historical lack of citizen involvement in economic and government decision-making has led to the underdevelopment of citizen involvement with and experience needed to operate market-oriented democracies. Consequently, CAR began the transition process far behind the other former Soviet Union states.

Principal Findings

USAID's Assistance Has Contributed to Economic and Democratic Reforms

USAID, in conjunction with other donors and the host governments, has helped the two republics most committed to reform—Kazakhstan and the Kyrgyz Republic—begin the transition to market-oriented democracies. USAID has concentrated its reform efforts on these two republics, providing \$150 million and \$83 million, respectively, since fiscal year 1992, or more than 85 percent of USAID's economic and democratic assistance to CAR.

- USAID's overall economic reform strategy is to help the CAR governments (1) privatize state-owned enterprises, (2) introduce tax and budget reforms, (3) promote the growth of private enterprise, and (4) improve the financial sector.
- USAID's democratic reform initiatives are aimed at promoting democracy at the national level, increasing citizen participation in economic and political decision-making, and advancing more responsive local government.

USAID provided advisors, training, small grants, and some equipment to assist both governmental and nongovernmental organizations (NGO) in

⁴United States Assistance and Economic Cooperation Strategy for Central Asia (Washington, D.C.: Department of State, July 1994).

designing and implementing economic and democratic reforms. For example, in Kazakhstan and the Kyrgyz Republic,

- USAID helped privatize 17,000 and 1,000 small to medium-sized, state-owned enterprises, respectively; adopt modern tax codes; enact commercial legislation; convert over 2,000 enterprises to the use of international accounting standards; improve the banking systems; and establish stock exchanges. In the Kyrgyz Republic, USAID helped the government join the World Trade Organization.
- USAID helped increase public participation in the political process by developing over 2,500 NGOs; strengthening over 100 independent radio and television news stations; and assisting in organizing town hall meetings, political debates, and public hearings.

USAID has not provided much assistance to the other three republics. The Turkmenistan and Uzbekistan governments generally have not been committed to reforms, and civil strife has limited opportunities to initiate reforms in Tajikistan. State and USAID rank Tajikistan, Turkmenistan, and Uzbekistan as having made the least progress in their transition to sustainable, market-oriented democracies compared to other countries in NIS. Nevertheless, USAID has assisted with some accomplishments in each country, such as privatizing about 500 small state-owned enterprises in Tajikistan, increasing the number of NGOs in Turkmenistan, and implementing a modern tax code in Uzbekistan.

USAID and State officials said it could take decades before CAR's transition to market-oriented economies is complete. USAID's economic reform initiatives have been supported by the national governments, at least in part, because of the potential income from foreign investment and resource development. Yet, despite the privatization of nearly two-thirds of the small- and medium-sized enterprises in Kazakhstan and the Kyrgyz Republic, many large enterprises are still owned and operated by the governments. Moreover, many of the laws and regulations that support a market-oriented economy are either not being enforced or are nonexistent—new tax codes have not been effectively enforced, most commercial legislation has not been fully implemented, and the banking sector has not been fully reformed. In all the republics, corruption is longstanding and pervasive. For example, unnecessary export licensing processes remain a source of bribery and corruption.

With the exception of the Kyrgyz Republic, the CAR governments have been slow to initiate democratic reforms because they threaten the

incumbent governments' control. Only the Kyrgyz Republic has committed to hold free and fair elections at the presidential and parliamentary levels. Democratic development is still characterized by a lack of citizen involvement and government controls over the broadcast news media have led to self-censorship and a reluctance to report stories that might offend public officials.

USAID Has Incorporated Lessons Learned From Other Similar Programs

USAID officials said that incorporating lessons learned from Central Europe and Russia was inherent in the CAR program's design and implementation, as illustrated by the following:

- Based on USAID's approach to privatization in Central Europe, USAID designed an integrated plan for market development. USAID found in Central Europe that five elements were essential to enable private sector growth following privatization. These included the development of (1) tax reform to support the financial obligations of the government; (2) the legal framework for commercial, trade, and investment activity; (3) accounting reform to provide credible financial data for economic decision-making; (4) bank reforms to provide the capital for private sector growth to improve corporate governance; and (5) stock markets to help enterprises raise capital. USAID incorporated each of these elements in its development plan for the republics.
- Based on USAID's experience in Eastern Europe and Russia, USAID has focused its democratic assistance on working with citizens to develop a civil society that would push for democratic reforms from the bottom up, rather than focusing on the national government. USAID found in Russia that without the political support of national leaders, assistance targeting national institutions and political processes was not likely to achieve democratic reform. USAID has adopted this strategy to establish and support nongovernmental organizations to build consensus for democratic reform and has purposely avoided providing direct assistance to national governments that have not been supportive of democratic reform.

These and other lessons applied in CAR were identified through various studies, conferences, and staff experiences. Although the use of lessons learned was envisioned from the start of the USAID program in CAR, USAID is now taking steps to develop a more formal system. USAID officials said such a system would help identify and disseminate lessons learned more effectively than the current system.

USAID Is Meeting Its Oversight Requirements

USAID ensures that assistance funds are spent for intended purposes through various project oversight requirements. USAID regulations and guidance generally require its cognizant technical officers to maintain communications with contractors and grantees, conduct site visits to verify work performance, and review programmatic and financial reports to compare actual progress and costs against expected results and costs. GAO reviewed seven economic and seven democratic reform projects in CAR and found that USAID had complied with its oversight requirements.⁵

Recommendations

GAO is not making any recommendations in this report.

Agency Comments

The Department of State and USAID were provided a draft of this report for comment. USAID provided written comments (see app. I), which State said it concurred with. USAID also provided technical comments that we have incorporated, as appropriate. In its written comments, USAID noted that the report makes a number of important points about the region and does a good job of describing USAID's efforts in CAR. USAID also provided a listing of recent changes in CAR that are not specifically addressed in the report.

⁵Funding for the economic reform projects selected represented \$136 million or 62 percent of the total economic assistance to CAR since fiscal year 1992. Funding for the democratic reform projects selected represented \$32 million or 60 percent of the funding for democratic assistance since fiscal year 1992.

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Abbreviations

CAR	Central Asian Republics
CTO	cognizant technical officer
IMF	International Monetary Fund
NGO	nongovernmental organization
NIS	newly independent states
USAID	U.S. Agency for International Development
WTO	World Trade Organization

Introduction

Significant economic, political, and security interests have shaped U.S. assistance to the five Central Asian Republics (CAR)—Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. In addition to furthering the nuclear disarmament of Kazakhstan, U.S. interests in CAR include (1) promoting market-oriented economic reforms; (2) establishing democratic political institutions; (3) developing energy resources in the region; and (4) fostering regional stability, including the movement toward greater integration with western and international institutions. This report examines the U.S. Agency for International Development's (USAID) assistance program to help each of these republics develop market-oriented economies and make the transition from communism to democracy. Since fiscal year 1992, USAID has provided about \$274 million to assist CAR in this transition.

U.S. Economic and Democratic Reform Strategies

The FREEDOM Support Act of 1992 authorized a broad foreign assistance program for the independent states of the former Soviet Union that included development of market-oriented economies and democracy building. The current U.S. strategy for CAR forms the basis for USAID economic and democratic reform initiatives.¹ The strategy seeks to have each country adopt and implement policies, laws, and regulations that provide the framework for market-oriented economies and democratic societies. Specifically, the strategy calls for

- competitive, market-oriented economies in which the majority of economic resources are privately owned and managed and
- transparent (open) and accountable governments and the empowerment of citizens, working through civic and economic organizations that ensure broad-based participation in political and economic life.

The U.S. strategy recognized the importance of other donors in the region, including the International Monetary Fund (IMF), the World Bank, and the European Bank for Reconstruction and Development. These institutions have provided CAR over \$4.3 billion in financial assistance since 1992, and significantly influence economic reforms by setting certain requirements or "conditions" for their loans and grants. The strategy called for systematic in-country coordination with these and other donors to avoid duplication,

¹United States Assistance and Economic Cooperation Strategy for Central Asia (Washington, D.C.: Department of State, July 1994).

to assure consistency in programming and advisory services, and to leverage U.S. resources.

USAID has developed strategic objectives, action plans, and strategies for its own programs to implement the U.S. strategy. Table 1.1 illustrates USAID funding for its economic and democratic reform initiatives in CAR for fiscal years 1992-98.

Table 1.1: USAID Obligations for CAR Economic and Democratic Assistance Programs by Country, Fiscal Years 1992-98

Dollars in millions				
Country	Economic reform	Democratic reform	Total	Percentage of total
Kazakhstan	\$122	\$28	\$150	55
Kyrgyz Republic	70	13	83	30
Tajikistan	3	4	7	2
Turkmenistan	3	2	5	2
Uzbekistan	23	6	29	11
Total	\$221	\$53	\$274	100

Note: Obligations are commitments to provide federal funding resulting in the immediate or future outlay of funds.

Source: U.S. Government Assistance to and Cooperative Activities With the New Independent States of the Former Soviet Union, Fiscal Year 1998 Annual Report (Washington, D.C.: the Office of the Coordinator of U.S. Assistance to NIS).

The strategy also stated that the size and type of the U.S. assistance were expected to reflect the extent to which national leaders demonstrated a commitment to reforms. USAID has concentrated its economic and democratic reform efforts in Kazakhstan and the Kyrgyz Republic—the two republics most committed to reform. USAID has limited its assistance to Turkmenistan and Uzbekistan because of their lack of commitment to reforms, while Tajikistan has had few opportunities to initiate reforms due to civil strife.

USAID does not provide U.S. funds directly to the CAR governments. Instead it funds U.S. contractors and grantees that, in turn, provide technical assistance, small grants, and equipment to CAR government agencies and nongovernmental organizations (NGO) involved in economic and democratic reforms. For example, USAID hired experts to advise CAR ministries on drafting laws needed to privatize the state-controlled

economy. USAID advisors also worked with citizen groups to help develop NGOs and provide advice and equipment needed to establish independent broadcast news stations.

Historical Constraints to Development

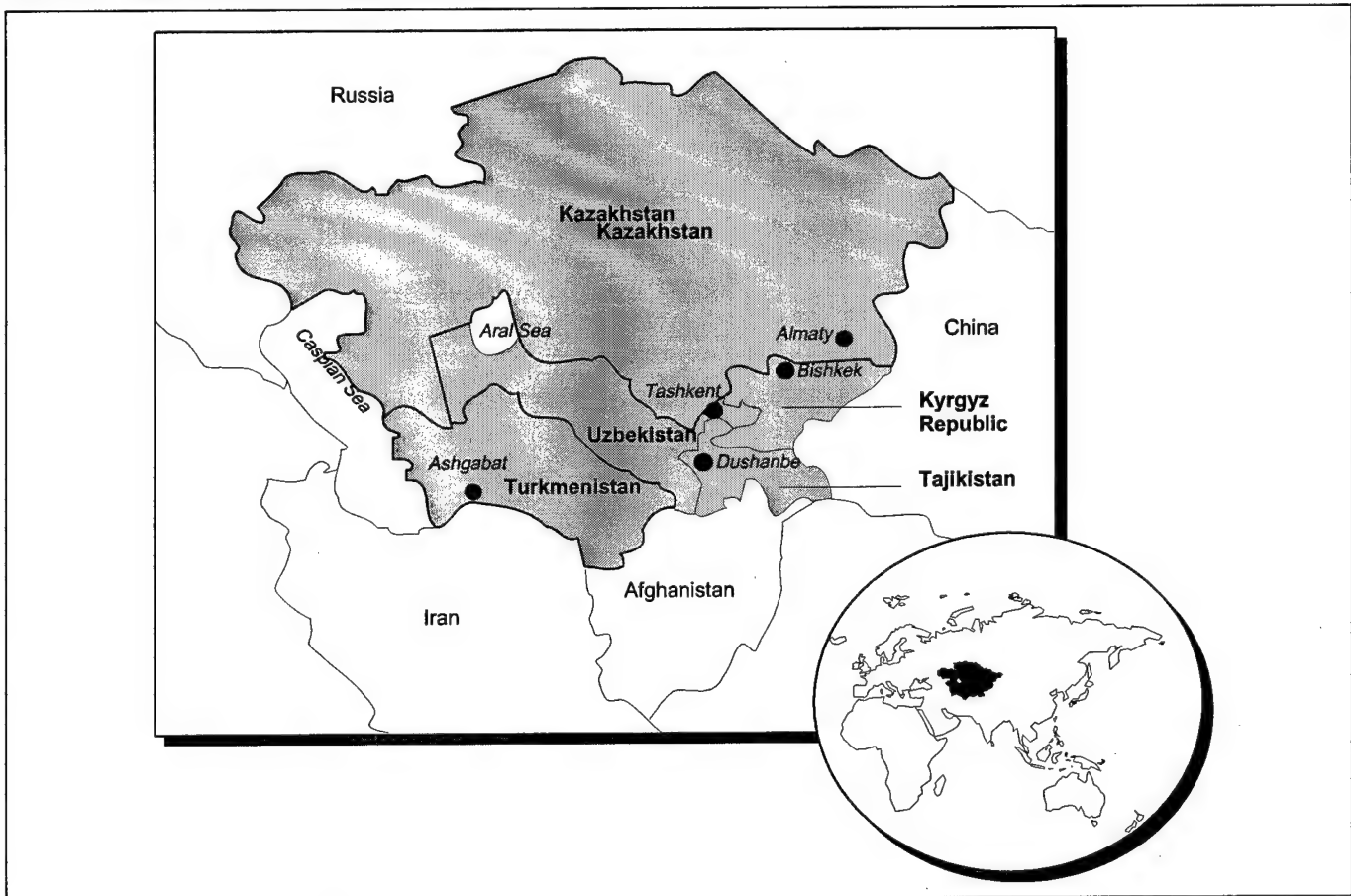
According to State and USAID, CAR is the most undeveloped region in the newly independent states (NIS) of the former Soviet Union. None of the countries had experience with market-oriented economies or democratic governments before the breakup of the Soviet Union. First Russian and then Soviet, domination left the area isolated from western technology, economic progress, and political development.

As a result, according to State and USAID, the development of market economies requires major changes in attitude and incentive systems for individuals as well as businesses. For example, USAID officials pointed out that in three out of the five republics, current leadership continues in the hands of former Communist Party chairmen who have recast themselves as national leaders, renamed the party, and were elected unopposed or with limited opposition. In general, according to State, the parliaments remain dominated by these national leaders, and there is little understanding of large-scale, rule-based democracy among the general public, who are largely disinterested in politics.

The Central Asian Republics

With the breakup of the Soviet Union, the United States and other countries recognized CAR's strategic location and largely untapped natural resources. Figure 1.1 illustrates the region's geographic significance, with CAR bordering China, Iran, and Russia.

Figure 1.1: Map of the Central Asian Republics



Following is a brief description of each of the republics.

- Kazakhstan is the ninth largest country in the world and stretches from Mongolia to the Caspian Sea. It has large reserves of oil, gas, and minerals. Its size, location, and overall political and economic stability have made Kazakhstan an important regional force. Despite being a very large country, Kazakhstan has a population of just under 15 million, according to a recent census, with a per capita income of \$1,300.
- The Kyrgyz Republic is a small, mountainous country situated south of Kazakhstan and west of China. It is landlocked, with few natural resources and limited industrial and agricultural production. The United States considers the Kyrgyz Republic an enthusiastic regional

reformer and views it as a "laboratory" for demonstrating the effectiveness of market-oriented democratic reforms. Its population of 4.5 million has a per capita income of \$440.

- Tajikistan is bordered by Afghanistan, China, the Kyrgyz Republic, and Uzbekistan. Civil war broke out in 1992 and, despite a 1997 peace accord, continued fighting poses a challenge to peace in the republic. U.S. assistance is primarily focused on humanitarian aid and promoting the peace process. Tajikistan's 6 million citizens have a per capita income of \$330.
- Turkmenistan is primarily a desert country, which borders Iran and Afghanistan. Turkmenistan possesses the world's fourth largest known reserves of natural gas and significant reserves of oil. Turkmenistan's population of 4.4 million has a per capita income of \$630.
- Uzbekistan borders the other four republics. The Department of State views Uzbekistan as central to maintaining the stability and independence of the region. Uzbekistan's 22 million population is the largest in CAR, and its relatively large market is viewed as a potential launching point for commercial expansion in the region. Uzbekistan's per capita income is \$1,000.

Objectives, Scope, and Methodology

To determine what USAID's economic and democratic reform initiatives were designed to achieve, what has been accomplished, and what factors have limited their implementation, we reviewed program documents, including State and USAID strategy documents and project assessments. We also interviewed State and USAID officials in Washington D.C., who designed and managed the program, and met with headquarter representatives of key USAID contractors and grantees involved with projects in CAR. Our references to and observations about CAR or former Soviet Union laws and regulations are based on interviews with USAID and CAR government officials and other secondary sources, rather than our own independent legal analysis.

In Kazakhstan and the Kyrgyz Republic, which accounted for about 85 percent of USAID's economic and democratic reform assistance to CAR, we reviewed USAID documents discussing accomplishments and impediments, survey data, and independent evaluations of USAID's economic and democratic reform efforts. We also met with the U.S. Ambassador to the Kyrgyz Republic; the U.S. Chargé d'Affaires in Kazakhstan; the USAID Director for CAR; various USAID project officers and USAID's in-country contractors and grantees; and host government officials, including members of parliament, the Supreme Court, and

government ministries. We visited project sites and observed training sessions to see how transition activities were implemented and to discuss the views of the recipients of USAID assistance.

To determine whether USAID applied lessons learned to its country programs in CAR, we reviewed program documents and evaluations of USAID's assistance programs in Central Europe and Russia and compared the strategy and program implementation with those of CAR. We interviewed USAID officials in Washington, D.C.; Kazakhstan; and the Kyrgyz Republic and analyzed program documents to catalogue examples of lessons learned. In the region, we attended regularly scheduled discussions hosted by the USAID mission with its contractors and grantees to see how program experiences were communicated and coordinated. Finally, we reviewed documentation used by USAID to identify and communicate lessons learned.

To determine how USAID ensures that its assistance funds in CAR are spent for intended purposes, we reviewed relevant federal regulations including Office of Management and Budget circulars; Federal Acquisition Regulations; and USAID regulations and guidance for contracts, grants, and cooperative agreements. To assess USAID's compliance with its oversight requirements, we selected seven economic and seven democratic reform projects as case studies. Funding for the economic reform projects selected represented \$136 million or 59 percent of the total economic assistance to CAR since fiscal year 1992. Funding for the democratic reform projects selected represented \$32 million or 64 percent of the funding for democratic assistance since fiscal year 1992. To determine if USAID was complying with USAID regulations, we reviewed the 14 project files; observed meetings between USAID and its contractors and grantees; conducted site visits; and interviewed contractors and grantees, cognizant technical officers, and USAID Office of Procurement officials.

We conducted our review from July 1998 to June 1999 in accordance with generally accepted government auditing standards.

USAID's Assistance Has Contributed to Economic and Democratic Reforms

In working with other donors and the CAR governments, USAID has assisted with a number of economic and democratic achievements in all the republics. These include privatization of small and medium-sized state-owned enterprises; trade, investment, and financial reforms; and the development of NGOs and independent broadcast news stations to promote reforms. However, most of the achievements have occurred in Kazakhstan and the Kyrgyz Republic—the two republics most committed to reforms. Officials from CAR governments and local NGOs said that USAID assistance was instrumental in furthering these achievements.

USAID and State officials said it could take decades before CAR's transition to a market-oriented democracy is complete. Even in Kazakhstan and the Kyrgyz Republic, many large enterprises are still owned by the governments; new tax codes have not been effectively enforced; most commercial legislation has not been fully implemented; and the financial sectors have made few loans. With the exception of the Kyrgyz Republic, none of the countries have instituted critical democratic reforms at the national level, such as holding fair and free elections for the heads of government, or endowing the legislative representatives with the independence or authority to challenge the executive branch. Furthermore, Tajikistan, Turkmenistan, and Uzbekistan have not demonstrated a commitment to implementing comprehensive reforms.

USAID and State officials cited several factors that have impeded reforms, including long-standing government corruption, the lack of resources to implement and enforce new laws and regulations, and the governments' limited commitment to implement comprehensive reforms at the national level.

Economic Reforms

CAR's command economies and its economic dependence on Russia present major challenges to the development of market economies in CAR. The historical lack of citizen involvement in economic decision-making has led to the underdevelopment of citizen involvement with and experience needed to operate market-oriented economies. USAID's efforts to promote economic reform have been impeded by these historical constraints, as well as by the resistance of CAR governments to make comprehensive economic reforms.

To facilitate CAR's transition to a market-oriented economy, USAID initiated programs to help the governments (1) privatize state-owned enterprises, (2) introduce tax and budget reforms, (3) improve the trade

and investment climate, and (4) develop the financial sector. Although USAID has provided assistance to all five republics, it has focused on Kazakhstan and the Kyrgyz Republic because they have been more supportive of reform.

USAID has helped the governments of Kazakhstan and the Kyrgyz Republic begin creating the foundation for market economies. Both have privatized most of their state-owned enterprises; passed market-oriented laws to spur commerce, trade, and investment; and created the basic institutions needed for banking and capital markets activities. However, the complete transition to market-oriented economies is decades away. Impediments include the limited government commitment to comprehensive economic reforms, inexperience in operating a market economy, insufficient resources to pay the costs associated with implementing new institutions and laws, and pervasive corruption in the region.

Privatization of State-owned Enterprises

In CAR, as in the rest of the Soviet Union, Moscow's central planners established production patterns based on political objectives rather than economic efficiencies. Free enterprise was not permitted, and monopoly production through giant state enterprises dominated economic activity, skewing incentive structures, misallocating resources, and encouraging wasteful production patterns. The privatization process sought to break the linkage between the government and enterprises to allow private sector activity to develop.

In its strategy, State considered privatization of state-owned enterprises to be the single most important element in the economic transformation of the region. Privatization was needed to transfer the majority of economic resources from the CAR governments to the private sector. USAID's assistance aimed to help CAR governments design and implement privatization programs. This included providing experts to help the governments put in place policies to promote competitive privatization procedures, such as methodologies to determine the value of state-owned enterprises, and procedures to accelerate their sale. They also trained local staff that worked closely with their government counterparts to help implement and monitor enterprise sales during the privatization process.

The degree of privatization has varied based on the governments' commitment to reforms. Kazakhstan, the Kyrgyz Republic, and to a lesser extent, Tajikistan, have been the most committed to privatization. For example,

- Kazakhstan privatized over 17,000 small- and medium-sized state-owned enterprises by the end of 1997, or nearly 70 percent of all state-owned enterprises in the country;
- the Kyrgyz Republic privatized approximately 1,000 enterprises by the end of 1996, or about 70 percent of small- and medium-sized enterprises; and
- Tajikistan privatized 500 small enterprises by the end of May 1998, and an estimated 65 percent of the small enterprises are now in the private sector, with the government planning to complete privatization of these small enterprises by the end of March 1999.

However, Kazakhstan and the Kyrgyz Republic have backed away from their commitment to privatize their largest, most profitable, state-owned enterprises, including those in the energy and mineral sectors. USAID considers privatizing these enterprises critical to the overall success of the economic reform efforts because of the potential foreign investment value and potential contribution to their respective countries' tax base. USAID and State officials said that corruption was a key factor in the governments' retrenchment, as it would reduce government officials' ability to control the enterprises for kickbacks and profit skimming. Tajikistan has not privatized many of its medium- and large-scale enterprises, and the process has been plagued by problems, such as how to value the enterprises. According to USAID/CAR¹ officials, Tajikistan has recently begun planning to privatize additional enterprises in response to deadlines required to meet World Bank loan requirements. Turkmenistan has rejected advice on privatization from USAID, the World Bank, and IMF because it lacks the commitment to reforming its economy.

Tax and Budget Reforms

Under the Soviet Union, tax systems often stymied the growth of private enterprise through excessive taxation, and none of the CAR governments had experience overseeing a decentralized, voluntary, compliance-based tax regime. Local governments were dependent on subsidies from the national governments and lacked the autonomy or the authority to raise and spend revenue on its needs. Annual budget allocations were based on ad hoc adjustments to traditional expenditure patterns, and performance-based budgeting was nonexistent.

¹We use USAID/CAR to refer to USAID's mission for CAR located in Almaty, Kazakhstan. USAID/CAR manages USAID's programs in all five republics.

USAID's action plan considered tax and budget reforms as necessary to help create a stable macroeconomic environment. USAID focused its efforts at the national level on (1) implementing modern tax codes and improving tax administration, (2) rationalizing the finance system between national and local governments, and (3) improving budget planning and implementation.

- In the tax reform area, USAID advisors provided technical support to the governments in the development of the new tax codes, provided technical support and training on tax administration, developed a strategy to automate tax administration, and helped develop software for the automated system.
- For fiscal decentralization, USAID provided advisory support and training to promote basic fiscal decentralization.
- In the budget reform area, USAID provided long-term advisors and training support designed to help the governments rationalize their expenditure process and provided technical expertise in the development of a budget process law designed to rationalize the annual budgeting process and modernize the budget classification systems.

With USAID assistance, Kazakhstan, the Kyrgyz Republic, and Uzbekistan became the first countries in NIS to adopt modern tax codes, enacting the new codes in 1995, 1996, and 1998, respectively. Kazakh and Kyrgyz officials said USAID assistance, which included drafting the new codes and providing training for its administration, was instrumental in gaining these achievements. Despite the enactment of the new tax codes, tax collection has not improved in Kazakhstan or the Kyrgyz Republic. According to USAID, these governments have not developed the strong tax administration capabilities necessary to improve tax collection efforts, and must substantially improve their tax collection to maintain macroeconomic stability. USAID is working with these governments to make these improvements but has been stymied by funding limitations and government resistance to fully implementing reforms.

USAID officials also stated that the governments had made little progress on intergovernmental finance and budget reforms. For example, according to a 1998 USAID report,² the following conditions existed:

- In Kazakhstan, the government was not committed to reforming its intergovernmental finance and fiscal analysis systems, and in budget reforms, the Ministry of Finance was resisting changing expenditure norms. In addition, ministry officials were unwilling to implement cash control systems necessary to prevent a commitment of funds beyond available resources.
- The Kyrgyz Republic had not proceeded with reforms of intergovernmental finance or the budget systems, despite assistance from USAID, the World Bank, and others. This was due, in part, to the relatively poor economic conditions of the local governments, which reduced their ability to implement reforms. As for budget reforms, the lack of automated systems reduced the government's ability to produce accurate budget reports.

More recently, according to USAID/CAR officials, the situation has improved in both countries, with USAID helping the governments develop program budgeting. USAID advisors are also helping to draft a law on intergovernmental finance in Kazakhstan.

Nevertheless, according to USAID/CAR officials, these reforms would have proceeded much more quickly if government bureaucracies in both Kazakhstan and the Kyrgyz Republic were less corrupt and less reluctant to cede power over funding sources. Regarding intergovernmental reforms, the Kazakhstan government has not wanted to decentralize control, while in the Kyrgyz Republic, the problem is the relative poverty of most regions—five of the seven Kyrgyz regions are financed by the remaining two, providing few options for a systematic solution. In addition, budget reforms are considered more difficult to make than tax reforms because there is little public interest in reforming a system that most people know little about. USAID officials said that both national and local government ministries have resisted the development of transparent budgets, fearing that it could lead to budget reductions. This occurred in Turkmenistan, for example, where USAID's fiscal reform program has made limited progress because, in part, ministries refused to reveal their real expenditures.

²Strategic Review of Fiscal Reforms in the NIS (Washington, D.C.: USAID, Oct. 1998).

Improving the Investment Climate

Under the Soviet Union, laws provided little protection for private property or investor rights, which dampened the willingness of domestic and foreign investors to invest in CAR. USAID is helping the CAR governments create the legal and regulatory systems needed to establish a stable investment climate for private enterprise. USAID's assistance is aimed at helping the governments (1) draft, pass, and implement key commercial laws and regulations; (2) join the World Trade Organization (WTO) which would help promote passage of commercial laws and help integrate the countries with international trade organizations; (3) implement international accounting standards to promote transparency and investment and improve management capability; and (4) improve the customs services to increase foreign investment.

Commercial Laws

The lack of commercial, trade, and investment laws has been a major impediment to the development of market-oriented economies in CAR. USAID's commercial law initiative is designed to put the legal and regulatory framework in place to promote commercial transactions and spur local and foreign investment in CAR.

With USAID assistance, Kazakhstan and the Kyrgyz Republic have adopted a number of commercial laws. For example, the Kyrgyz Republic passed a modern civil code (with sections on contracts, leasing, and intellectual property), as well as laws on collateral, bankruptcy, customs, procurement, and foreign investment. A judge on the Kazakhstan Supreme Court, as well as the Director of the Legal Department in the Kyrgyz White House, both of whom had participated in the reform efforts, said that USAID assistance was critical in the development and passage of their country's new commercial laws. According to USAID, these laws provide a basic framework for commercial activity.

According to USAID, neither government has fully implemented most of the new laws or developed the institutional capacity to enforce them. USAID officials said that the governments do not have the necessary funds to publish and disseminate new laws and regulations. Nor do the governments have adequate funds to train the thousands of administrators necessary to interpret and enforce the new laws and regulations. Furthermore, the governments have yet to establish an enforcement system for the efficient adjudication of commercial disputes.

World Trade Organization Accession

USAID has supported CAR efforts to join WTO as a way to promote a greater understanding of and commitment to trade and investment

liberalization.³ USAID/CAR officials have also encouraged WTO membership as a means to cement links with critical international institutions and to pursue policy dialogue on a number of investment issues. These include the passage of commercial laws on intellectual property rights, contracts, licensing, customs, tax administration, bankruptcy, and collateral. USAID has provided technical assistance and training support to encourage a range of investment reforms that are crucial for the economic growth prospects in CAR. USAID also provided assistance to help interested governments draft WTO membership documents and technical support to prepare the governments for negotiations with WTO on membership.

With USAID assistance, Kazakhstan, the Kyrgyz Republic, and Uzbekistan, have taken their initial steps toward WTO membership. In 1998, the Kyrgyz Republic became the first country in the former Soviet Union to join WTO. According to a director in Kazakhstan's Ministry of Energy, Industry, and Investment, as well as the Deputy Minister for Economic Policy in the Kyrgyz White House, USAID advisors played an indispensable role both in helping the countries' progress toward WTO membership and in encouraging overall trade and investment reforms.

Despite progress toward WTO membership by Kazakhstan, it missed a 1998 self-imposed goal to join WTO and failed to adopt key trade and investment-related legislation. USAID/CAR officials attributed this delay to pressure from Russia not to join WTO before Russia does, which, according to USAID officials, will not occur in the foreseeable future. Uzbekistan submitted its application for WTO membership but has not passed key commercial legislation necessary for membership. According to USAID officials, USAID has provided no assistance to Tajikistan because of the ongoing civil strife, and Turkmenistan has not made a commitment to join WTO.

International Accounting Standards

When CAR gained its independence, the republics had no standardized, credible financial data with which to make rational economic decisions. Without accurate, reliable financial data, private domestic and foreign firms, banks, and governments cannot make key business decisions.

³ WTO is a multilateral organization that provides the legal and institutional framework for the international trading system. It also serves as a forum for international trade negotiations.

To help provide accurate financial information, USAID has encouraged CAR to adopt International Accounting Standards as a means to attract international investment. USAID officials said that accounting standards are critical for potential investors to analyze and act on investment opportunities and for enterprise management's decision-making. USAID helped the governments implement the standards. In late 1996, Kazakhstan became the first of the former Soviet Republics to adopt International Accounting Standards, and as of December 1998, 1,500 Kazakhstani enterprises had converted to the new standards.

In January 1998, the Kyrgyz Republic became the second country in NIS to adopt the standards. USAID helped the Kyrgyz Republic convert approximately 800 enterprises to the new standards and trained over 260 accounting specialists in training institutions, audit and accounting firms, and enterprises undergoing conversions on how to implement the new standards.

However, USAID has not yet succeeded in establishing fully functional self-regulatory organizations required to develop and enforce professional standards for the accountants and auditors needed to fully implement the new standards. According to USAID/CAR officials, however, significant progress has been made in both Kazakhstan and the Kyrgyz Republic in this area during the first half of 1999.

Customs Reforms

To facilitate trade and investment, USAID has provided technical assistance to improve customs procedures in CAR. For example,

- Kazakhstan adopted rules to improve customs processing and has eliminated export tariffs and the requirement to register exports;
- the Kyrgyz Republic passed laws to eliminate repetitive and burdensome licensing requirements; and
- Uzbekistan passed both a customs code and a customs tariff law, as well as issuing implementing regulations on customs valuation.

According to USAID/CAR officials, corruption and the lack of political commitment to fully implement the new laws and complete additional reforms have hampered progress. In both Kazakhstan and the Kyrgyz Republic, the licensing process remains a source of bribery, with chaotic procedures and no standardization of requirements across ministries. Unnecessary licensing requirements remain both as obstacles to investment and sources of corruption. USAID officials also said that the governments lack adequate funds for training customs officials and do not

normally provide funding for the printing and distribution of new laws and regulations. The Director of the Legal Department of Kazakhstan's Customs Committee said that, as a result, customs officers are not always aware of new laws or regulations or understand how to interpret them.

Improving the Financial Sector

Key financial institutions, such as banks and capital markets, did not exist in the western sense in CAR. In response, USAID adopted two initiatives, banking reform and capital markets development, to promote private sector growth. According to USAID's strategy, these were needed to provide (1) new sources of capital to enterprises as they restructured under private ownership, (2) investors with accurate information on the financial status of newly privatized enterprises and (3) mechanisms for capital to flow to profitable enterprises and away from nonviable ones.

Banking Reforms

With USAID assistance, Kazakhstan and the Kyrgyz Republic have strengthened their financial sector through banking reforms. Central bank representatives from both countries said that USAID provided critical assistance in helping the banks implement international banking regulations and enhance their monitoring of commercial banks. These officials said that, as a result of these reforms, the health of the commercial banks has improved. For example,

- the Kazakhstan Central Bank closed insolvent banks and reduced the number of banks from 230 to 75 to improve capitalization through implementation of stricter licensing procedures; and
- the Kyrgyz National Bank implemented new capital adequacy requirements and closed insolvent banks; as a result, the number of banks meeting the new capital requirements rose to 85 percent in 1997 compared to 42 percent in 1995.

Despite these achievements, banking reforms are far from complete. In both Kazakhstan and the Kyrgyz Republic, the banking sector is lending at very low levels, with an adverse impact on business development. USAID and the central banks lack adequate funds to completely implement additional reforms, and the governments have not fully committed to supporting these reforms. For example, the Kyrgyz Republic has yet to complete the automation of its accounting system, adopt a modern payments system law, and implement an efficient electronic payments system for the banking sector.

Capital Markets Development

Institutional mechanisms for raising capital through equity or secured debt did not exist in CAR. USAID's strategy was to provide technical assistance and training support to the reform-minded governments in CAR to help develop key laws and institutions needed for securities markets, including a stock exchange, broker-dealer associations, and national securities commissions.

USAID assistance has helped Kazakhstan, the Kyrgyz Republic, and in a very limited way Uzbekistan develop and implement the laws, regulations, and infrastructure necessary to establish capital markets. USAID officials said that, despite these achievements, none of the three stock exchanges are fully developed.

- Activity on the markets is low due to public mistrust and limited savings and, more recently, the Asian and Russian financial crises and the resulting capital flight from the emerging markets.
- Both the Kazakhstan and Kyrgyz governments have pulled back from their plans to offer high-quality shares of state-owned enterprises for sale through the stock exchanges. USAID/CAR and U.S. embassy officials in Kazakhstan and the Kyrgyz Republic attributed these decisions to corruption associated with government control over these lucrative state-owned enterprises, as well as to low prices associated with the slump in the global commodities markets.
- For a while, the Kyrgyz Republic was not able to bring "gray market" (outside of the exchange) trading into the stock market. In May 1999, however, the Kyrgyz Republic ended this activity, which accounted for a significant percentage of trading. In order to enhance the prospects for sustainability, a Presidential Decree stipulated that all trading shall be conducted through the exchange.
- Uzbekistan has maintained government control over the securities regulatory body, the central depository, and the stock exchange. According to USAID officials, this is a clear conflict of interest, and as a result, these institutions have not developed.

Democratic Reforms

CAR's closed political systems, combined with the dual legacy of communism and CAR's centralized regimes, present major challenges to democratic development. The lack of citizen involvement in government decision-making has led to the underdevelopment of a civil society and fostered the belief that citizens have little ability to influence government decisions affecting their daily lives. USAID's efforts to promote democratic

reform have been impeded by these historical constraints as well as by the resistance of CAR governments to make the necessary changes.

As a result, USAID has focused its assistance on CAR citizens, as opposed to national institutions, in an effort to develop a broad-based consensus for democratic change. USAID is promoting increased and better-informed citizen participation in political and economic decision-making. To meet this goal, USAID has (1) targeted national pro-reform officials to promote democratic reforms, (2) helped develop NGOs to lobby for reforms, (3) increased independent news media to better inform CAR citizens, and (4) recently initiated a program to promote democratic reforms at the local government level.

Promoting Effective Government at the National Level

USAID has sought to increase the CAR governments' transparency, responsiveness, and accountability to its citizens by assisting newly elected legislatures, judicial bodies, and electoral commissions to organize and carry out their functions. USAID worked to support the development of democratic institutions and practices within national governments (except in Turkmenistan) by targeting pro-reform government officials for assistance. USAID provided (1) training and technical assistance to improve parliamentary practices and legislative drafting; (2) legal resource and judicial training centers in order to help organize the legal system, improve training, and adopt ethical codes of conduct; and (3) electoral law development and civic/voter education in preparation for upcoming local, parliamentary, and presidential elections.

- In Kazakhstan, USAID focused its democracy assistance on areas outside of national government institutions, concluding that the government would not support democratic reforms. The Kazakhstan government is dominated by its president, who was recently reelected to a second 6-year term. However, the primary opposition candidate was not allowed to run in the election, which the U.S. embassy considered flawed. Despite the government's resistance to democratic reforms, USAID has had some recent successes in promoting government accountability, including staging a debate where parliamentary candidates discussed issues in a nationally televised broadcast for the first time.
- The Kyrgyz Republic is considered the most open and democratic country in the region and, unlike in the other republics, USAID has provided technical assistance and training to the parliament and judiciary. For example, USAID training and liaison support increased

the capacity of the parliament to initiate and draft legislation. USAID also played an active role in persuading members of the parliament to meet with their constituents and allow USAID-assisted NGOs to contribute to the legislative process.

- Tajikistan is still emerging from over 6 years of civil war. A peace accord signed between the government and the opposition in June 1997 formally ended the civil war. However, splinter groups and warlords fighting over the drug trade have continued to destabilize the country. Due to the political situation, USAID has focused its democracy activities in Tajikistan on promoting and supporting the peace process. However, USAID also provided guidance on constitutional and judicial reform issues and assisted the government in developing a voter registration system to promote elections to meet international standards.
- In Turkmenistan, the president has dominated the national government since his days as head of the Communist Party in 1985. According to State, the president has retained power over the judiciary and a 50-member parliament. Given this, USAID has limited democracy programs in Turkmenistan.
- In Uzbekistan, USAID has made limited progress assisting the government in becoming more transparent and accountable to its citizens. According to State, Uzbekistan is ruled by a highly centralized presidency, comprised of the president and a small circle of advisers. Nonetheless, USAID's efforts recently resulted in the formation of a judges' association and its adoption of a code of ethics, signs that provide some encouragement for future reform initiatives.

With the exception of the Kyrgyz Republic, CAR's governments have resisted opening and liberalizing government and have impeded USAID's efforts to promote democracy at the national level. As a result, USAID attempted only modest reform efforts to achieve this goal and targeted its assistance in areas where it was most likely to achieve positive results. Government officials in the region were largely holdovers from the Soviet period. State officials noted that these officials were generally tolerant only to democracy initiatives that were not perceived as threats to their control and so have largely resisted democratic reforms at the national level.

Developing NGOs

Because USAID views CAR as lacking the political commitment to institute democratic reforms at the national level, it has focused on promoting democracy by increasing citizen participation through the development of

NGOs. According to USAID, the underlying rationale for this approach is that systemic reforms cannot be forced upon a government. If the political will to reform does not exist at the national level, then primary emphasis needs to be placed on local level reforms.

USAID has worked with NGOs that are active across a wide spectrum of disciplines, from economic to social development. A growing number are involved in public advocacy efforts and, through targeted USAID training and technical assistance, have demonstrated a capacity for developing governmental relations, providing public education, and performing community organizing. For example, a film documentary on tuberculosis produced by a public advocacy organization led the Kazakhstan government to initiate a tuberculosis eradication campaign. Also, an NGO in the Kyrgyz Republic that 2 years ago was unable to obtain an appointment with government officials now has its counterparts in the government regularly travel to the organization's offices to coordinate with them on consumer rights legislation and regulations.

USAID's effort to develop the CAR's NGO sector has achieved measurable results. Less than 5 years ago, the only NGOs were social welfare organizations connected with the government and a limited number of environmental groups. At the end of 1998, over 2,500 were active in CAR—609 in Kazakhstan, 870 in the Kyrgyz Republic, 515 in Tajikistan, 117 in Turkmenistan, and 439 in Uzbekistan—an increase of 65 percent from 1996. USAID played a critical role in the development of these NGOs by providing training, technical assistance, legislative drafting, and legal support.

Despite these achievements, the NGOs in CAR still have funding and other problems that challenge their viability. The majority of NGOs are dependent on external financing to maintain operations and activities. Most organizations have low memberships and a narrow constituency base. The majority of these organizations—which are predominantly located in the capitals and some major cities—have an urban bias and underserve rural areas. USAID officials told us that pending legislation in several of the CAR parliaments, such as tax laws on charitable giving, would be a key factor in enhancing the sustainability of NGOs. USAID was assisting in drafting and supporting the passage of such legislation.

political decision-making. A diverse flow of information is a means to promote government transparency and accountability and serves as protection against corruption. USAID worked to strengthen and promote independent media by providing (1) radio and television station management training, (2) technical assistance, (3) broadcast equipment, and (4) legal and legislative drafting assistance.

USAID assistance has helped strengthen over 100 independent news broadcasting stations and has provided citizens with an alternative to state-controlled media. USAID assistance has contributed to an increase in independent daily news broadcast time and the percentage of the population with access to independent news. For example, USAID estimates that in Kazakhstan, 26 television and 18 radio stations averaged 25 minutes of independent daily news broadcast time, and 40 percent of the population had access to independent news. Similarly, in the Kyrgyz Republic, 16 television and 11 radio stations averaged 20 minutes of independent daily news broadcast time, and 81 percent of the population had access to independent news. The number of stations and news time in Tajikistan and Uzbekistan was less impressive, but nonetheless had increased as the result of USAID's efforts. USAID has not conducted independent media activities in Turkmenistan because the government opposes an independent media.

USAID's training was highly valued by media officials we met. Station management training modules were credited with making outlets more economically viable, and the provision of broadcasting equipment was viewed as a key input that enabled stations to be competitive with state-owned stations in terms of production quality. USAID legal assistance was responsible for helping broadcast stations throughout the region obtain licensing and maintain compliance in an uncertain regulatory environment, thereby preventing many stations from being closed.

Despite the gains in independent media outlets, serious challenges to the media exist in the region. The greatest challenge to an independent media was in Kazakhstan, where recent actions by the government, including cost-prohibitive rates for licenses, have increased government controls over the media and resulted in the closing of 36 television and radio stations. In addition, throughout CAR, the independent media face many common problems, including challenges to editorial independence and to economic survival. Independent stations are subject to both direct and indirect pressure from government officials. According to media officials we spoke with, there is a clear understanding on their part about what can

and cannot be reported, and self-censorship is practiced. Government officials at the national and local level apply pressure to restrict reporting on political matters, resulting in the media's shying away from stories that might offend public officials. USAID officials report that governments manipulate access to information by channeling information to government-controlled stations. Finally, many independent stations, especially those located outside major urban areas, have difficulty generating advertising revenues to sustain their operations.

Assisting Local Governments

In the summer of 1998, USAID began promoting effective, responsive, and accountable local governments in Kazakhstan and the Kyrgyz Republic.⁴ By supporting the development of democratic institutions at the local level, USAID sought to promote decentralization, citizen involvement, and appropriate resource management.

Historically, CAR has had little experience with local government, as most administrative and financial decision-making power resided at the national level. USAID is providing a broad array of technical assistance, including assistance in budgeting, financial management, competitive procurement systems, public hearings, and policy development guidance to local government officials.

In Kazakhstan, USAID has been limited in its ability to address local government reforms due to resistance by the national government. USAID assisted in several attempts to draft an effective local government law to increase fiscal and administrative decentralization, but the national government either withdrew or weakened the draft laws before submitting them to parliament. This was largely because after independence, the national government allowed oblasts (provinces) significant autonomy, but several northern oblasts with large Russian populations pressed for secession from Kazakhstan. As a result, the national government significantly limited its efforts to give local government greater authority and autonomy. USAID's start-up activities have been hampered by the lack of a national government counterpart to coordinate and advocate for local government initiatives.

⁴USAID has not pursued this strategic objective in Turkmenistan or Uzbekistan due to a lack of central government commitment to local government reform and in Tajikistan due to the ongoing civil conflict.

According to USAID officials, the Kyrgyz Republic government appears committed to decentralization, and it is beginning the process of devolving authority to local governments. Elections for council members were held in over 450 villages, and all villages had enacted charters (20 towns, including the capital, Bishkek). The national government created an Office of Local Government that actively promotes an agenda to strengthen local government. The existence of a counterpart agency in the government facilitated start-up activities, and most of USAID's project tasks were being implemented on schedule. However, despite these achievements, local governments remained constrained by the Ministry of Finance's control over their budgets. Until local governments are able to generate sufficient revenue to cover their expenses, the ability to achieve effective, responsible local government will be significantly limited.

CAR's Economic and Democratic Transitions Are Far From Complete

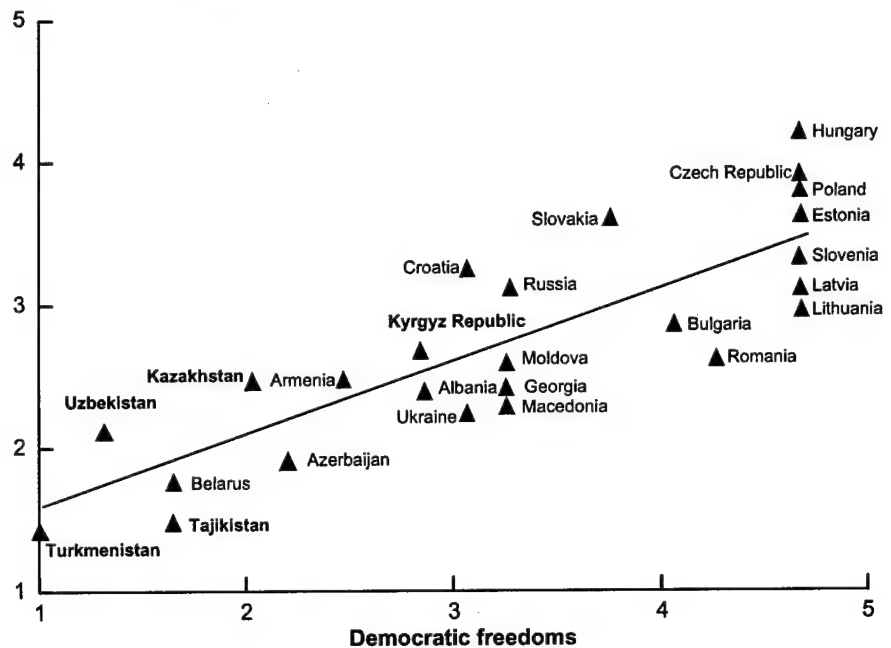
USAID and State monitor the pace of economic and democratic transitions of the 25 countries that constitute Central Europe and NIS. A 1998 State/USAID report⁵ ranked three of the five countries in CAR—Tajikistan, Turkmenistan, and Uzbekistan—among the least economically and democratically developed of the 25 countries that made up Central Europe and the former Soviet Union. The semi-annual report used a wide variety of indicators drawn primarily from non-U.S. government sources such as the Freedom House and the European Bank for Reconstruction and Development Investment. These indicators cover such areas as whether (1) most of the gross domestic product is derived from private enterprises, (2) foreign investment and foreign trade are encouraged, (3) the head of state and parliaments are elected through free and fair elections, and (4) the media is free and independent.

The Kyrgyz Republic was rated the most advanced in CAR with economic and democratic reforms ranked 12 and 16, respectively. Kazakhstan was ranked 16 economically and 21 politically. Figure 2.1 depicts the economic reform and democratic freedom rankings for the countries of Central Europe and NIS.

⁵Monitoring Country Progress in Central and Eastern Europe and the New Independent States (Washington, D.C.: USAID and the Department of State, Apr. 1998).

Figure 2.1: Ratings of Economic Policy Reforms and Democratic Freedom in Central Europe and NIS

Economic policy reforms



Source: Monitoring Country Progress in Central and Eastern Europe and the New Independent States.

The report also noted that none of the 25 countries have completed their economic and democratic transitions. Even the most reformed countries, such as Poland and Hungary, still have far to go relative to the economic policies of industrial market-oriented economies. In addition, the report said that CAR, like others in the former Soviet Union, have implemented the "easiest" reforms, such as privatizing small and medium-sized enterprises and passing new laws. None of the countries in the former Soviet Union or Central Europe have completed the hardest transitions. These include implementing commercial laws, banking reforms, and capital markets development—reforms that often challenge the vested interests of the ruling elite or require the full involvement of the region's citizens.

USAID/CAR officials agreed that, despite the accomplishments in CAR, the transitions are far from complete and the remaining tasks are the most

difficult. However, they noted that the State/USAID rankings do not give sufficient credit to the amount of progress made by CAR, particularly Kazakhstan and the Kyrgyz Republic. They said that the region was much less developed than those countries in Central Europe that had a tradition of market-oriented democracies to build upon and the report's rankings do not adequately portray the degree of movement thus far. They noted that neither the ruling elite nor their citizens have any experience with the institutions nor the behaviors needed to operate market economies and democracies and that this could take generations to develop. Given the historical constraints to development in CAR, and where CAR began the development process, USAID/CAR officials said that Kazakhstan and the Kyrgyz Republic had made considerable progress since the beginning of the USAID program.

USAID's 1998 Agency Performance Report further stated that CAR, like other areas of NIS, continues to have transition difficulties.⁶ According to the report, two-thirds of USAID's economic programs failing to meet USAID expectations were in NIS. Contributing factors included (1) the difficulties of replacing entrenched communist institutions, (2) USAID's limited experience (approximately 10 years) in helping countries transition from communism compared to its 40 years of development work, (3) the limited USAID field presence in NIS, and (4) unexpected political and economic crises. Democratically, the report ranked Kazakhstan, Tajikistan, Turkmenistan, and Uzbekistan as "not free," while the Kyrgyz Republic was ranked "partly free." The report stated that all of the countries in NIS continue to face challenges to a fuller transition to democracy. Organized crime and corruption undermine effective governance, while the economic woes of the republics leave citizens little time for political participation.

Conclusions

USAID has helped Kazakhstan and the Kyrgyz Republic begin the transition to market-oriented economies and lay the foundation for democratic, civil societies. Kazakhstan and Kyrgyz officials said that USAID assistance was instrumental in their achievements. However, the reforms are far from complete, and further development of the region must be considered a long-term effort. USAID's economic reform initiatives have been supported by the national governments, at least in part, because of the potential income from foreign investment and resource development. In contrast, with the exception of the Kyrgyz Republic, the CAR governments have

⁶1998 Agency Performance Report (Washington, D.C.: USAID, Apr. 1999).

Chapter 2
USAID's Assistance Has Contributed to
Economic and Democratic Reforms

been slow to make democratic reforms because they threaten the incumbent governments' control.

USAID Has Incorporated Lessons Learned in Its Car Programs

Incorporating lessons learned from Central Europe and Russia into the CAR program was envisioned from the beginning of the program. State's strategy document stated that lessons learned from Central Europe and the other regions of the former Soviet Union would figure prominently in the design and implementation of the CAR programs.¹ USAID's action plan for economic reforms was based on USAID's economic reform efforts in Central Europe. USAID officials noted that the application of lessons learned was inherent in devising their program strategies and operations, and numerous channels exist for their continued utilization. Nevertheless, USAID recently began an effort to formalize its lessons learned process to help the agency identify and communicate those lessons.

Lessons Learned

USAID/CAR officials provided numerous examples of lessons learned from similar programs in Central Europe and Russia that had been applied to the economic and democratic reform programs in CAR. They said that the identification and implementation of lessons learned was an integral part of their planning and program operations. Among the most prominent lessons were that USAID should (1) take an integrated approach to privatization to help create the enabling environment necessary for private sector development, (2) coordinate with other donors working in the region, (3) focus democratic assistance at the grassroots level if national governments do not support democratic reforms, and (4) ensure that NGOs and independent media have the necessary legal and financial underpinning for sustainability. USAID officials said that lessons learned emanated both from efforts to refine ongoing USAID programs as well as in response to specific problems identified in Central Europe and Russia.

Economic Reform Lessons Learned

Based on USAID's approach in Central Europe, USAID designed an integrated approach to market development. USAID found in Central Europe that five priority areas must coincide with the privatization process to create the enabling environment needed for private sector development. These include development of (1) tax reform to support commercial development and the fiscal sustainability of the government; (2) commercial laws and regulations to provide the legal framework for trade, investment, and commercial activity; (3) accounting and audit reform to provide the standardized and credible financial data necessary

¹United States Assistance and Economic Cooperation Strategy for Central Asia.

for rationale economic decision-making; (4) bank reforms to provide the capital for private sector growth and improve corporate governance; and (5) capital markets development to serve as a source for enterprises to raise capital and provide market discipline. USAID incorporated all five elements in its action plan and has accomplishments in each area.

Also using lessons learned from Central Europe, USAID/CAR has coordinated with other donors working in CAR. Although USAID provides relatively small amounts of money compared to the World Bank and IMF, USAID found that by working with these institutions it could use its expertise to help countries implement World Bank and IMF programs that support USAID goals. USAID/CAR has employed this approach. For example, USAID/CAR worked with (1) the World Bank to get commercial banks in Kazakhstan to convert to international accounting standards; (2) IMF to train monetary policy officials in Kazakhstan and the Kyrgyz Republic on how to implement IMF's macroeconomic stabilization programs; and (3) IMF to develop tax codes for Kazakhstan, the Kyrgyz Republic, and Uzbekistan.

USAID/CAR also used USAID's successful approach in Central Europe to help integrate CAR into the world economy by developing their links with international multilateral economic institutions, such as the World Bank and IMF. Central European countries, according to USAID, had a strong incentive to proceed with reforms based on the prospects of memberships with these western institutions, and the reforms required for such membership are closely aligned with USAID objectives. For example, USAID used the Kyrgyz Republic's desire to join WTO to encourage the passage of commercial, trade, and investment laws needed for membership. Similarly, all the republics in CAR are members of the World Bank and IMF, and the Kyrgyz Republic has joined WTO.

Democratic Reform Lessons Learned

USAID has focused its democratic assistance on citizens rather than on the national government. In Russia, USAID found that without the political support of national leaders, assistance targeting national institutions and political processes was unlikely to achieve democratic reform. This lesson is especially relevant for CAR, where four of the five national leaders have resisted democratic reforms. As a result, USAID worked with citizen groups to help develop a civil society that would push for democratic reforms. Thus far, the CAR national governments and institutions have not been directly affected and, as previously noted, USAID has helped numerous NGOs get started.

Based on USAID's experience in countries throughout the former Soviet Union, USAID worked to provide the legal foundation to establish NGOs. USAID has given legislative drafting assistance to parliaments, using examples of laws adopted elsewhere in NIS to encourage a number of legislative reforms. These laws are intended to help NGOs develop and thrive, and secure their right to exist and operate in society.

In addition, in Russia, USAID found that the biggest problem facing independent television and radio stations was maintaining their economic viability. As a result, USAID has incorporated advertising and business management seminars into its CAR training programs. In addition, to help stations increase their revenues with advertising, USAID has also commissioned ratings surveys to demonstrate to potential advertisers the audience levels of the independent stations.

USAID Is Formalizing Its Lessons Learned Process

These lessons learned (and others) were identified by USAID through various channels, including USAID conferences, publications and reports, and weekly and monthly discussions between USAID and its contractors and grantees. In addition, USAID's selection process for hiring advisors gives significant weight to prior work experience in the former Soviet Union. These advisors in turn had their own mechanisms for incorporating lessons learned into their activities.

Although numerous lessons learned from Central Europe and Russia have been applied in CAR, USAID's Bureau for Europe and New Independent States has begun considering ways to help ensure that such experiences are not overlooked or forgotten. According to USAID officials, the "lessons learned" system has been largely dependent on staff sharing their experiences with one another. But many veterans of the region are retiring or rotating to different posts. USAID risks losing their acquired knowledge and expertise without a central mechanism to identify, analyze, and communicate lessons learned. Consequently, the Bureau has undertaken a number of stock-taking exercises to extract "lessons learned." These include assessments of nearly 10 years of progress on each of the Bureau's program objectives. In the fall of 1999, USAID plans to sponsor a "Lessons in Transition Conference," where public and private sector leaders from all NIS countries will exchange experiences in transforming their economic, political, and social systems. The Bureau is also preparing a strategic plan that will incorporate lessons learned into guidance for field missions. On this foundation, USAID plans to begin development of a more formalized system to identify and communicate lessons learned.

USAID Complied With Its Oversight Requirements

Oversight for assistance activities in CAR is shared between USAID headquarters in Washington, D.C., and USAID/CAR in Almaty, Kazakhstan. Initially, all U.S. assistance activities in CAR were managed from Washington, D.C., as was the case with other NIS countries because USAID had few staff and resources in the region. As USAID/CAR's staffing has increased, USAID has shifted the management of assistance activities to the mission to provide for more direct oversight and greater accountability. According to USAID, USAID/CAR managed about 65 percent of USAID's assistance programs in CAR as of December 1998. By the end of fiscal year 1999, USAID/CAR expects to manage 80 percent of USAID's assistance programs in CAR.

USAID safeguards its assistance funds to CAR through various oversight requirements. For the 14 CAR activities we examined,¹ USAID is meeting its project oversight requirements for contracts, grants, and cooperative agreements—the financial instruments used by USAID.² USAID regulations and guidance³ generally require its cognizant technical officers (CTO) to provide oversight of contractor and grantee activity. According to these regulations and guidance, CTOs are required to maintain communications with contractors and grantees, conduct site visits to verify work performance, and review programmatic and financial reports to compare actual progress and costs against expected results and costs. CTOs working with contracts must also maintain files documenting significant actions, and, while not specifically required, CTOs are encouraged to do the same for grants and cooperative agreements.

USAID's regulations and guidance give broad authority to CTOs to determine the level of required oversight. For example, CTOs have wide latitude in determining how often they should communicate with contractors or grantees and how many site visits they should conduct. According to USAID's Office of Procurement, this gives CTOs the discretion to determine how best to manage their programs.

¹Funding for the economic reform projects selected represented \$136 million or 62 percent of the total economic assistance to CAR since fiscal year 1992. Funding for the democratic reform projects selected represented \$32 million or 60 percent of the funding for the democratic assistance since fiscal year 1992.

²Contracts are used to acquire property or services. Grants and cooperative agreements are used to transfer money, property, or services to grantees whose programs support U.S. goals and objectives. We use "grantee" to refer to both grant and cooperative agreement awardees.

³USAID oversight guidance for contracts is in its "Contractor Information Bulletin 93-8," while the oversight requirements for grants and cooperative agreements are in its Automated Data System-303 regulations.

Communications

CTOs are required to maintain regular communications with the contractor or grantee. We found that USAID/CAR CTOs had regular, if not daily, interactions with contractors and grantees via telephone and electronic mail, and weekly meetings with contractors and grantees at USAID/CAR offices for program updates and coordination of development strategies. In addition, CTOs, contractors and grantees, and the Ambassador met monthly to discuss progress on and impediments to meeting project goals and objectives. USAID/CAR also had country representatives in each of the satellite offices in the Kyrgyz Republic, Tajikistan (until all U.S. personnel were evacuated in mid-1998), Turkmenistan, and Uzbekistan who maintained communication with CTOs, monitored projects, and served as liaisons for the contractors and grantees and the respective embassies.

The five Washington, D.C.-based CTOs we interviewed said that they maintained regular communication with the U.S. offices of contractors and grantees. We documented examples of this communication, including electronic mail, facsimiles, and telephone conversations with their U.S. offices concerning progress and impediments in meeting project objectives, workplans, and funding issues. In addition, they relied upon project officers in USAID/CAR for oversight of contractor and grantee activities in CAR. These project officers attended the weekly and monthly USAID/CAR meetings with contractors and grantees used to assess program status.

Site Visits

CTOs are required to visit project sites to help gauge project progress. USAID's Office of Procurement officials stated that CTOs could meet this requirement by delegating this responsibility to project officers in country. CTOs for the projects we reviewed all met USAID's requirement.

In the USAID/CAR project files we reviewed, we found numerous trip reports documenting CTO site visits. For example, USAID/CAR CTOs and staff attended a conference on accounting conversion and evaluated a contractor's progress toward implementing accounting reforms at two Kazakhstan factories. We also participated in numerous site visits with CTOs in Kazakhstan and the Kyrgyz Republic. During these site visits, CTOs met with the contractors and grantees as well as with government and NGO officials.

Two of the five Washington, D.C.-based CTOs we interviewed had conducted site visits in CAR. But, due to time and resource constraints,

these CTOs said they often relied on project officers at USAID/CAR to make site visits on their behalf.

Performance and Financial Reports

CTOs are required to review periodic performance and financial reports filed by the contractor or grantee. CTOs we interviewed all used performance and financial reports submitted by contractors and grantees to monitor performance and progress toward meeting project objectives and to verify key cost elements in the award. Several Washington, D.C.-based CTOs said that, given their distance from CAR, reviewing performance reports was critical to staying informed about grantee activities. We also found that CTOs used the reports to evaluate the performance of contractors and to support USAID/CAR's contractor performance reports. Based on these reports, in one instance, USAID/CAR forced a contractor to make personnel changes to improve project performance.

CTOs we interviewed also reviewed financial reports submitted by contractors and grantees to determine whether USAID funds were properly expended. Records in the files we examined showed that CTOs had reviewed the financial reports for correctness and appropriateness of costs billed to USAID, as required. CTOs at USAID/CAR assessed the accuracy of the financial reports based on their weekly and monthly meetings with their contractor or grantee, site visits, and review of performance reports. Washington, D.C.-based CTOs said that they relied on information from USAID/CAR project officers, the contractor and grantee, performance reports, and past experience when reviewing the reasonableness of costs.

USAID/CAR officials stated that further verification provides additional assurance that costs billed by contractors conform to award provisions. USAID/CAR was conducting line-by-line payment verifications on all the monthly vouchers submitted by contractors, using time and attendance sheets; expense records for travel, per diem, and direct costs; and other financial documentation. USAID/CAR officials stated that this level of effort was justified based on an October 1998 analysis that found that five of eight contractors in CAR provided inadequate documentation to support their vouchers or presented questionable costs for reimbursement. For the three USAID/CAR-managed contracts we reviewed, payment verifications had been done.

Files

USAID requires CTOs to keep files that include financial and program reports; CTO trip reports; briefings; and correspondence among the contractor, the contracting officer, and CTO. Based on our review of three USAID/CAR contract files, all were in compliance with USAID regulations. However, the USAID/Washington, D.C., contract file we reviewed was missing all monthly and quarterly performance reports. The CTO stated that he had received and reviewed the reports, as required, but his files were not readily available, and we could not independently verify his assertion.

Although CTOs are not required to keep files for grantees, CTOs for the one grant and five cooperative agreements we reviewed maintained files that included program reports, vouchers, and correspondence among the grantee, CTO, and project officers in country. Files for the five cooperative agreements we reviewed also contained workplans and staffing approvals for the grantee's in-country personnel.

Comments From the U.S. Agency for International Development



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

July 14, 1999

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
National Security and International Affairs Division
U.S. General Accounting Office
441 G Street, N.W. - Room 4039
Washington, D.C. 20548

Dear Mr. Hinton:

I am pleased to provide the U.S. Agency for International Development's (USAID's) formal response on the draft GAO report entitled, "FOREIGN ASSISTANCE: U.S. Economic and Democratic Assistance to the Central Asian Republics" (June 1999).

The report reflects both the care and professionalism of its authors. It makes a number of valid and important points about the region and its strategic importance to the United States. The report accurately distinguishes the Central Asian Republics (CAR) from the other Eastern Europe and former Soviet Union Republics, noting that they have not had previous experience as nation states. Therefore, the report concludes correctly that reform in Central Asia began from a different starting point than these other republics, but notes that USAID used lessons learned elsewhere to inform our efforts in CAR.

The report also does a good job of summarizing USAID's significant achievements in promoting reforms and its careful stewardship of U.S. taxpayer resources. While it describes the conditions prevailing in the region through the end of 1998, there have been some significant changes during the first half of 1999 that also could be noted. The enclosure highlights the most significant changes. We also recommend a few minor word changes (bold highlight) on pages 36, 43 and 44 which are also enclosed.

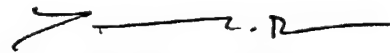
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Appendix I
Comments From the U.S. Agency for
International Development

2

Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,



Terrence J. Brown
Assistant Administrator
Bureau for Management

Enclosure: a/s

ENCLOSURE

Significant changes during the first half of 1999 in the Central Asian Republics.

- *The Financial Times* (July 1, 1999) printed an article declaring that "Kazakhstan's pension reform programme is perhaps the most ambitious of its kind." The article described the USAID sponsored program as "an outstanding success".
- In the Kyrgyz Republic, the Ministry of Finance and all government agencies have been trained on program budgeting for the purpose of preparing the 2000 budget. The Government of Kazakhstan recently passed a new Budget System Law.
- The Kyrgyz Republic has become the acknowledged leader among the Newly Independent States in converting its banking sector to the use of International Accounting Standards (IAS). The entire commercial banking sector and central bank are now automated and IAS compliant. In Kazakhstan 65% of commercial bank assets have completed IAS conversions in the last seven months.
- In Kazakhstan, the parliament passed a law that gives the Chamber of Auditors the authority to adopt auditing standards and set professional qualifications. Through June 1999, USAID has trained over 1800 accounting specialists in International Accounting Standards (IAS) in the Kyrgyz Republic and over 6000 in Kazakhstan.
- In May, 1999, the Kyrgyz Republic announced new plans to privatize packets of state-owned shares on the stock exchange. Also, in June, 1999, the Government of Kazakhstan announced a new privatization plan that includes large scale enterprises.
- The Government of Kazakhstan has made substantial progress in the last six months towards meeting the requirements of World Trade Organization (WTO) accession and plans to submit its Offers on Goods and Services to WTO in September, 1999.
- The President of the Kyrgyz Republic signed a new Election Law in June 1999. It is the most progressive election law in Central Asia and it relaxes many strict requirements on political parties. The law also better defines election procedures and media coverage of upcoming elections. USAID/CAR is now supporting the development of enabling regulations and assistance to the Central Election Commission to equitably implement this new legislation.
- In May, the Government of Uzbekistan adopted the new "Non-Governmental Non-Commercial Organization Law". The first of its kind in Central Asia, the new law allows for the legal registration of NGO's. USAID/CAR is now assisting the development of supporting regulations and of processes for equitable implementation. Also, on July 1st, the Legislative Assembly of the Kyrgyz Republic passed a new law "On Non-Governmental (Non-Commercial) Organizations" containing a series of progressive provisions for public associations and foundations.

Appendix I
Comments From the U.S. Agency for
International Development

- In the Kyrgyz Republic, a new Coalition for Democracy and Civil Society, consisting of approximately 65 NGOs, has been formed with USAID assistance. The Coalition organizes town meetings and roundtable meetings with members of Parliament and the President's office to discuss legislative issues such as the recently signed Election Law.

GAO Contacts and Staff Acknowledgments

GAO Contacts

Jess T. Ford, (202) 512-4268
A.H. Huntington, III (202) 512-4140

Acknowledgments

In addition to those named above, Edward J. George, Jr.; Patrick A. Dickriede; Jodi M. Prosser; Jiyeon Chung; and Rona Mendelsohn made key contributions to this report.

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